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FISCAL IMPACT STATEMENT

LS 7365

BILL NUMBER: SB 491

NOTE PREPARED: Jan 20, 2004

BILL AMENDED:

SUBJECT: Property Tax Replacement.

FIRST AUTHOR: Sen. Borst

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Property Tax:* This bill eliminates the authority of the state and political subdivisions to impose a property tax after December 31, 2005, except to pay debt service obligations and public safety services. The bill imposes a special assessment for public safety services on residential property and property otherwise exempt from property taxes (other than certain governmental and religious property) instead of an ad valorem property tax. The bill also eliminates most property tax deductions and credits, except for a deduction for the elderly, blind, and disabled and a deduction for inventory.

Sales Tax on Services: This bill extends the Sales Tax to all services other than medical services and certain other services. It provides for the distribution of the revenue to political subdivisions.

Local Budget Oversight: The bill transfers oversight of local budgets from the Department of Local Government Finance (DLGF) to the State Budget Agency. It provides an optional method to reorganize political subdivisions and makes related changes.

This bill repeals property tax credits, property tax deductions, remonstrance provisions that are superseded and replaced by provisions in this act, and certain laws granting authority to the Department of Local Government Finance.

Effective Date: Upon passage; July 1, 2004; July 1, 2005; December 1, 2005; January 1, 2006; February 1, 2006.

Summary of State Impact: This bill would have an overall positive state impact of \$407 M in FY 2006, \$389 M in FY 2007, and \$497 M in FY 2008. The impact is summarized as follows.

Summary of State Fiscal Impact			
	FY 2006	FY 2007	FY 2008
Additional Net State Revenue	951,000,000	2,029,700,000	2,191,200,000
Additional State Expense	543,650,000	1,640,500,000	1,694,200,000
Net State Effect	407,350,000	389,200,000	497,000,000

Explanation of State Expenditures: *Property Tax:* Under this proposal, the state would be responsible for replacing a large portion of local budgets. State expenditures in addition to current funding for PTRC and Homestead Credits under this bill for CY 2006 are estimated at \$1,628 M. Funding would come from the Property Tax Replacement Fund. The fiscal year cost is estimated at \$544 M in FY 2006 (partial year) and \$1,640.5 M in FY 2007 (full year).

The table below estimates the sources of funding needed to replace the current gross property tax levy. The total state obligation for CY 2006 is estimated at \$3,906 M. However, since the state would already pay an estimated \$2,278 M in PTRC and Homestead Credit under current law, the net additional state expense is \$1,628 M.

Estimate of Local Budgets and State Funding - 2006

Current Estimated 2006 Gross Levy	\$7,524 M	
Less: Public Safety Costs (Funded by special assessments and tax levy)	2,454 M	
Less: Debt Service Levies Continued	<u>1,164 M</u>	
Remaining Budget to be Funded by State		3,906 M
Less: Current Est. 2006 Homestead Credit		249 M
Less: Current Est. PTRC		<u>2,029 M</u>
Total Additional State Cost		<u>\$1,628 M</u>

Local Budget Oversight: The State Budget Agency, rather than the Department of Local Government Finance (DLGF), would assume all local government budget oversight duties. All data collection and studies that are currently required of the DLGF would become the responsibility of the State Budget Agency. It is assumed that the DLGF's budget division would be transferred to the Budget Agency. There could be some savings of administrative costs since the number of funds with tax rates that need to be calculated would be significantly reduced.

Sales Tax on Services: Expanding the Sales Tax to include most service transactions would have a significant impact on the Department of State Revenue (DOR) insofar as the Department would be required to develop rules and procedures related to the expansion. Additionally, the Department would be required to make new determinations on the applicability of the direct use exemption on services purchased by firms offering goods and services.

The funds and resources required above could be supplied through a variety of sources, including the

following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions. As of December 29, 2003, the DOR had about 124 vacant full-time positions, and they reverted \$2.8 M in FY 2003.

Explanation of State Revenues: *Sales Tax on Services:* Beginning December 1, 2005, this bill extends the state's 6% Sales Tax to sales of services. The bill also adjusts the distribution of Sales Tax revenue so that the additional revenue will be deposited in the Property Tax Replacement Fund and state General Fund. (It is assumed that all of the additional revenue will be used for local property tax replacement.) This provision is estimated to generate approximately \$954.1 M in FY 2006 and approximately \$1,985.7 M in FY 2007. Based on the timing and remittance of Sales Tax collections, this estimate assumes collections from six of the seven months that the tax is in effect during FY 2006. In current year terms, expanding the Sales Tax base is expected to generate approximately **\$1,908 M in CY 2006 and \$2,063 M in CY 2007.**

The estimates above are based on economic data from the U.S. Census Bureau, adjusted for growth in Indiana income. The estimate assumes that 75% percent of business-to-business transactions would be exempt from the Sales Tax based on the direct use exemption. The bill specifically exempts health services from the Sales Tax.

State Property Tax: **State property tax revenue losses are estimated at \$3 M in FY 2006 (½ year) and \$6 M in all other years under this provision.** The state currently imposes a statewide property tax rate of \$0.0024 per \$100 AV for the State Forestry and State Fair Funds. The state property tax generates around \$6 M per year with about \$2 M going to State Fair and \$4 M going to State Forestry. FY 2003 revenues totaled only \$4.5 M because of property tax billing delays. Under current law, after billing schedules are returned to normal, annual revenue should return to about \$6 M per year. Beginning in CY 2006 under this proposal, the state would no longer impose this tax and would forgo the revenue that it generates.

Individual Income Tax Deduction for Property Taxes: With the significant reduction in property taxes, this bill will also reduce the amount of the property tax deduction taken on the individual adjusted gross income tax return. This is expected to increase individual income tax revenue by approximately \$50 M beginning in FY 2007.

Background: Approximately 1.2 M taxpayers claimed \$1.37 B in this deduction for tax year 2001 for a tax impact of \$46.6 M.

Explanation of Local Expenditures: *Property Tax:* The State Budget Agency would calculate an expenditure limit for each civil taxing unit. The limit would equal the unit's previous year per capita appropriations multiplied by the unit's population for the upcoming year and increased by an income growth index. The income growth index would be equal to the current assessed value growth quotient which is the average annual increase in Indiana nonfarm personal income, capped at 6%. (The 2004 factor is 4.7%.)

Explanation of Local Revenues: *Property Tax:* Beginning in CY 2006, this proposal would prohibit local civil taxing units and school corporations from imposing most property tax levies.

Local units would impose an annual special assessment for public safety costs on each one- or two-unit residential property (both owner-occupied and rented) and on most previously exempt properties. Property owned by the federal, state, or a local government and property owned by a religious institution would

continue to be exempt. The balance of all public safety costs would be funded through a property tax levy assessed on all nonexempt property that does not pay the annual special assessment.

Local civil taxing units and school corporations would continue to impose a property tax levy for debt service upon all nonexempt property. Most business and individual property tax deductions would be repealed, except for the elderly, blind or disabled, and 100% inventory deductions. This would broaden the tax base and reduce the resulting tax rate.

The rest of local revenues needed to replace property tax levies would come from state appropriations.

The bill would also allow a “special assessment” to be imposed in lieu of a tax increment replacement levy for TIF areas.

It is estimated that the gross property tax levy under current law in CY 2006 will be about \$7.5 B. Taxing units would not be able to impose this entire levy under the bill. The cost of public safety is estimated at \$2.45 B in CY 2006. The special public safety assessment would generate an estimated \$732 M of that amount, leaving about \$1.72 B to be levied against nonexempt property that is not subject to the special assessment. The gross levy for debt service is estimated at \$1.16 B in CY 2006 and would remain intact.

Total local effort would be reduced by an estimated \$1,627 M in CY 2006, \$1,666 M in CY 2007, and \$1,750 M in CY 2008. These amounts would be paid by state appropriation from revenue generated by the sales tax on services. There would not be any overall change in local revenues.

Individual Income Tax Deduction for Property Taxes: With the reduction in the amount of the property tax deduction on the individual income tax return, the adjusted gross income base will increase, thereby increasing the base for local option income taxes. Those counties that impose a local option income tax will see an increase in local option income tax revenue.

State Agencies Affected: Department of Local Government Finance; State Budget Agency; Department of State Revenue.

Local Agencies Affected: All local civil taxing units and school corporations.

Information Sources: Local Government Database; U.S. Census Bureau.

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